THE FEDERAL RESERVE BANK of ST. LOUIS

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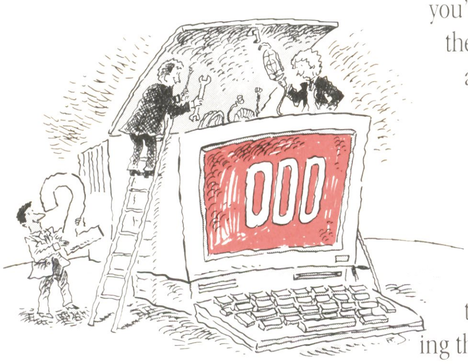
News and Views
for
Eighth District Bankers

Getting Ready for the Year 2000



Are your institution's computers ready for the year 2000? If you're like most bankers, the answer's no. And, although it may seem like a way off, the Federal Reserve, among other supervisory agencies, is urging financial institutions to begin preparing their computing operations now for the new millennium.

The problem that many banks and others will face when the century changes is that their operating systems and programs are set up for six-digit date fields, with two of the digits allocated for the year. If a bank employee enters the year as 00 for 2000, most computers will read it as 1900, causing obvious problems in date-sensitive calculations.

What should financial institutions be doing? The Board of Governors advises the following:

1) Perform a risk assessment to determine which systems and applications must be modified, how long it will take to do so and how much it will cost;

2) Investigate the computer systems of service bureaus and vendors to see if they are addressing the issue and how to compensate for them if they're not;

3) Complete all reprogramming efforts in time for adequate testing—Dec. 31, 1998 at the latest.

Information systems examiners will be looking at each financial institution's awareness of the year 2000 issue during the regularly scheduled examination process.

Fed, NACHA Approach Companies on Direct Deposit

As part of its joint campaign with the National Automated Clearing House Association to increase the electronic initiation of payments, the Federal Reserve System is approaching corporations nationwide to educate them about the benefits of direct deposit.

Later this month, the Fed and NACHA will send out roughly 15,000 informational brochures about direct deposit to the human resources directors or controllers at companies with 200 to 500 employees. The brochure explains the benefits direct deposit can bring businesses and how they can go about increasing usage at their own organizations. Companies also will receive a second brochure titled, "A Consumer's Guide to Direct Deposit," which they can reproduce and distribute to their customers.

In addition to the direct company mailing, the Fed and NACHA will also send 13,000 of the corporation-oriented brochures to the American Payroll Association, which will insert copies of it into its members' magazine.

The point of both mailings is to increase the use of direct deposit for payroll and to encourage its use for other types of recurring payments, such as tuition reimbursement and expense settlements.

"Our goal is to see companies begin to approach their financial institutions for help with direct deposit services," says Kathleen Paese, ACH officer at the St. Louis Fed.

Feditorial

The Electronic Challenge

Hank Bourgaux

Electronic payments are hot news today and gaining more coverage as consumers become increasingly comfortable with the technology that spawns them. Despite the well-publicized benefits of electronic payments, however, we're not anywhere close to being the checkless society experts predicted 20 years ago. So what's holding us back?

I believe one of the biggest challenges financial institutions face is the uncertainty that emerging payment methods present. By investing in innovative technology, such as virtual banking and electronic cash, bankers must take a chance that a particular payment system will become widely accepted. If a financial institution prefers a surer route, however, it could start expanding its existing ACH systems and electronic payments portfolios to include more advanced applications, such as electronic data interchange. The time is also ripe for financial institutions to encourage customers to make or receive payments using basic ACH services.

Revenue is another concern. Financial institutions have made significant investments in their current paper-based payment processing systems, and purchasing new technology is expensive. Although revenues from paper-based products aren't easily replaced with income from electronic services, institutions can achieve cost savings by building electronic payment volumes.

While there are risks in the electronic payments arena, there are also many incentives and opportunities. As a banker, you have the ability to provide payments expertise, offer products individually or through alliances with others and supply the settlement services that nonbank entities lack.

These advantages put you a step ahead of your nonbank competitors in offering customers new electronic products and services. And as electronic payment mechanisms become as accepted as ATMs in the next 10 years, you will be in a prime position to take advantage of these opportunities.

Hank Bourgaux is senior vice president of the Federal Reserve Bank of St. Louis.

Banks Get Creative with Check Imaging

It's been just over eight months since the St. Louis Fed began offering its check imaging service, and the number of uses for image continue to multiply. The service was originally envisioned as a way for financial institutions to reduce backroom expenses such as paper handling and postage costs, item retrievals and storage. Now, some institutions are discovering additional benefits—those that even Fed employees hadn't thought of.

"Some of our best ideas come from customers," says Rick Johns, a St. Louis Fed account executive. "They'll say, 'Can you do this for me?' and we'll say 'Not yet, but give us a little while.' "

One use that has blossomed considerably is image-enhanced corporate cash management, which enables banks and credit unions to provide their customers with online histories of their check transactions in CD-ROM format. Some institutions are using the service as a source of fee revenue by obtaining it from the Fed and then upcharging it.

Others are beginning to use image to store their official checks. And at least one credit union has decided to have all of its customers' items imaged so that it has an easy and efficient long-term storage method. Johns says that because the image service is flexible by nature, it can help banks and credit unions streamline operations in many ways. For a demonstration of the Fed's check imaging service, contact your account executive.

R. Alton Gilbert

Should Nonbank E-Cash Providers Be Treated Like Banks?

The recently completed Olympic games in Atlanta not only showcased great athletic competition, they also unveiled a new means of making payment through the use of what is commonly called electronic cash. Although it has yet to be determined whether Atlanta's experiment with Visa's version of a stored value or "smart" card was a success, we do know that some larger issues must be examined before the country makes a full-scale shift to e-cash.

Among the most salient is what to do about the nonbank firms that have begun offering electronic payment services directly to the public. Should these new entrants to the payments business be required to get bank charters, and be supervised and regulated as banks by government agencies?

My answer to this question is based on the impact these new entrants could have on the safety and soundness of the payments system. One view is that market forces will ensure a stable payments system by limiting the risk assumed by nonbank providers. Therefore, according to this view, no government supervision or regulation of these nonbank payment service providers would be necessary to ensure the safety and soundness of the payments system.

I disagree. My views are based on U.S. banking history. Prior to the formation of the Federal Reserve in 1914 and the creation of federal deposit insurance in the 1930s, the U.S. payments system was vulnerable to major disruptions whenever depositors lost confidence in the soundness of their banks. For example, between the Civil War and the formation of the Federal Reserve System, major banking panics occurred in the United States in 1873, 1893 and 1907. During these panics, banks suspended payment of currency to their depositors, which created major disruptions in economic activity. Market discipline clearly did not ensure a safe payments system in these cases. In contrast, consider the performance of the payments system in the United States since the 1930s: No major disruptions have occurred.

> Extension of government supervision and regulation to e-cash providers is a logical step.

Almost all nations have government safeguards—central banks and agencies that supervise and regulate all payment service providers—in place to prevent such disruptions. Even the nonbank providers of small denomination payment instruments, such as travelers checks and money orders, are supervised and regulated—by state governments. Governments have established these institutions to deal with the vulnerability of their economies to disruption in their payments systems. Thus, extension of government supervision and regulation to all providers of electronic money is a logical step in the progression of banking history.

Is it, therefore, necessary to subject all providers of payment services to government supervision and regulation at this time? Probably not. Currently, there is a significant amount of research and development in the payments system, and the dollar amounts of payments settled through electronic cash are small. The government should limit any actions that would discourage this research and development.

If electronic money does succeed, however, I expect the firms in the e-cash business to be supervised and regulated as banks—a point that may be reached either through deliberate planning, or through some future crisis brought on by the inclusion of new entrants to the payments business. With foresight, we could increase the chances of the former and decrease those of the latter.

R. Alton Gilbert is a vice president in the Research Division at the Federal Reserve Bank of St. Louis.

This article is based upon a longer version, which is available from the author upon request, as well as on this Bank's Internet site, http://www.stls.frb.org/research/gilbert.html.

Regional Roundup

New Memphis Account Exec Named

Susan Bivens has been hired as the Eighth District's new Memphis Branch account executive. Bivens brings over

25 years of commercial banking experience to the District. Most recently, she served as assistant vice president/manager at Victory Bank & Trust Co., in Cordova, Tenn., where she directed daily operations. Before that, Bivens spent seven years in a similar position at NationsBank of Tennessee. In her new position, Bivens will be responsible for servicing the 300 financial institutions in the St. Louis Fed's Memphis area.

St. Louis Account Execs Swap Assignments

Andy Lueckenhoff, the St. Louis Fed account executive who formerly visited Illinois institutions, has been assigned new duties as Automated Clearing House account executive for the entire Eighth District. In this capacity, Lueckenhoff will promote Fed ACH services District-wide, including helping financial institutions explain ACH to their customers. Lueckenhoff's previous experience, both as an account executive and as a manager of the Fed's ACH and Wire Transfer Department, has prepared him well for his new duties.

Rick Johns has replaced Lueckenhoff as the account executive who will serve Illinois institutions. Johns will also retain responsibility for his current customers. Rick Sires will continue to serve as account executive for institutions in the Missouri portion of the St. Louis Zone.

1995 HMDA Data Available

Reports of 1995 mortgage lending activity are now available to the public at central depositories throughout the nation. The reports include individual disclosure statements and aggregate data for each metropolitan area. They reflect the lending activity for more than 9,500 institutions covered by the Home Mortgage Disclosure Act.

The 1995 figures include 11.2 million reported loans and applications—a decrease of 8 percent from 1994 that largely reflects a drop in refinancing activity. Despite the overall decrease in the number of conventional home purchase loans, however, those made to Black, Hispanic and Native American applicants increased.

For a copy of the 1995 HMDA data, contact the Federal Financial Institutions Examination Council at (202) 634-6526.

New Louisville VP Named

On May 16, Ron Byrne was appointed vice president of the St. Louis Fed's Louisville Branch. As such, Ron is responsible for the Eighth District's marketing and product development activities, as well as serving as managing officer over the Louisville Support Services and Check/Data Processing departments. Ron comes to

the St. Louis Fed with 30 years of commercial banking experience. Most recently, he was president of Liberty Payment Services Inc. in Louisville.

Fedline to Warn of Late Postings

Many account holders have taken advantage of the Fedline Monitor Balance Reports to supplement their internal records. We realize, however, that occasional operational delays can cause transactions to be posted later than normal and that institutions may have difficulty reconciling the totals reported through Fedline with their own internal reports.

To minimize confusion, when we know that there will be a significant delay in the posting of transactions—especially one in the late afternoon—the St. Louis office will send a broadcast to all online institutions alerting them of the situation, so they can accurately compute their end-of-day balances. If the Fedline system is not operating, we will send the broadcast to institutions by fax.

As always, institutions that are having difficulty in reconciling their account totals are encouraged to contact Payments Risk Management in St. Louis or their Accounting Department in the Branch offices.

Second Chance for Risk Management Planning

The Federal Financial Institutions Examination Council is conducting a second risk management planning conference on Sept. 26-27 in Kansas City, Mo. Executives and officers from banks, thrifts and credit unions who would like help establishing or improving institutional risk management standards are encouraged to attend. For more information, contact the FFIEC at (703) 516-5487.

Word-of-Mouth Grows Fed's Truncation Service

When Maxine Pakovich, president of the SWIC SIU Credit Union in Edwardsville, Ill., first heard the cost savings the Fed's truncation service would bring her institution, she was skeptical. "It just sounded to good to be true," she says. "We kept saying, 'There's got to be a catch somewhere.'"

Three years later, Pakovich has yet to find that catch and is eager to provide a ringing endorsement of the Fed's truncation service to any credit union willing to listen—and even those who won't. "I can't understand why anyone in their right mind wouldn't do this," she tells them. Pakovich has even gone so far as to become a sort of satellite St. Louis Fed sales office, showing other interested credit unions how the Fed service works before they make the decision to switch over. At least three have signed on with the Fed so far. "We keep waiting for our commission," Pakovich jokes.

Maxine E. Pakovich, president, SWICSIU Credit Union

What is it about the Fed's truncation service that Pakovich finds so irresistible?

- ***Cost***—Pakovich says that this is what initially convinced her to make the Fed her truncation service provider. "We saw a definite savings," she says. When she looks at other credit unions' charges now, she is astounded. "Their costs are astronomical compared to ours."
- ***Efficiency***—The time and paperwork saved by having the Fed truncate her credit union's checks after processing them is significant, Pakovich says. "All we eliminated was a middle man. When we had to retrieve anything, it got cumbersome. Why deal with going through a third party?"
- ***Service***—Pakovich says that although the cost of the Fed's truncation service is what hooked her, the good customer service she gets is what keeps her. "You develop a personal knowledge of the people working there," she says.
- ***Ease of transition***—For those who are concerned that switching to the Fed would be too much trouble, Pakovich says not to worry. "One beautiful thing was that the change was transparent to us," she says. "We didn't have to do a lot of work to prepare for it. We didn't have to make a lot of changes."

With all of that in mind, Pakovich says there's no way she could keep her knowledge of the Fed's truncation service to herself. "Credit unions exchange ideas all the time, and if you have a good idea, you want to spread the news," she says.

Ron Hadorn, account executive at the St. Louis Fed's Louisville Branch, says that news of the Fed's truncation service has spread around the Louisville area, too. Since the beginning of the year, the Branch's customer base has increased by 60 percent, and the volume of items processed has more than doubled, thanks in large part to the addition of L&N Credit Union—one of the biggest credit unions in the state. "And we're still going strong," Hadorn says.

For more information on the Fed's truncation service, contact your account executive.

FedFacts

Fed to Answer Taxing Questions

The Eighth District will hold several half-day seminars this fall to help those who have questions about EFTPS, the Electronic Federal Tax Payment System. Internal Revenue Service code requires taxpayers who made deposits of more than $50,000 in federal employment taxes for calendar year 1995 to begin making payments using EFTPS starting Jan. 1, 1997. This summer, the IRS began notifying the 1.2 million taxpayers who will be mandated to file and pay their taxes electronically.

The seminars will give an overview of EFTPS and address topics such as EFTPS reporting methods, the enrollment process, the tax payment process, the impact on financial institutions operations, and the way to send EFTPS over Fedline. For more information on seminar dates, times and locations, check the Calendar section at right or contact Susan Hackney of the St. Louis Fed's Treasury Relations Department at (314) 444-8485.

District Advisory Council Members Sought

The Eighth District has several openings available on its Economic Advisory Council, an eight-member body that advises the St. Louis Fed and its Branches on small business and agriculturally related matters. The council meets twice a year with St. Louis Fed President Thomas C. Melzer and other senior officers to offer advice and observations on emerging District conditions. Those interested in being nominated to the council should contact Randy Sumner at (314) 444-8644.

Members are also needed to serve on the Board of Governors' Consumer Advisory Council, which represents consumer and community interests and the financial services industry. Those interested in serving on the Consumer Advisory Council should contact Deanna Aday-Keller, council secretary, at (202) 452-6470.

Positions for both councils begin in January 1997 and run for three years.

Board Weaves Wider Web

The Board of Governors has expanded its Internet World Wide Web site to include:

- the Humphrey-Hawkins report and testimony;
- pictures and biographies of Board members and Fed presidents, both current and former;
- the Beige Book;
- a calendar of Federal Open Market committee meetings, as well as recently released FOMC minutes; and
- five additional statistical releases.

The Board's web site can be found at http://www.bog.frb.fed. The St. Louis Fed's web site, which links to the Board's site, is at http://www.stls.frb.org.

Calendar

Upcoming Fed-sponsored Events for Eighth District Depository Institutions

Community Affairs Meetings
Oct. 7 - Columbia, Mo.
Oct. 22 - Little Rock, Ark.

District Dialogues
Sept. 25 - St. Louis
Oct. 22 - Springfield, Mo.
Oct. 23 - Fort Smith, Ark.

EFTPS Seminars
Oct. 28 & 29 - St. Louis
Nov. 5 & 6 - Little Rock, Ark.
Nov. 13 & 14 - Louisville, Ky.
Nov. 18 & 19 - Memphis, Tenn.

Treasury Issues/ACH Origination Seminar
Oct. 16 - St. Louis

For more information on the above meetings, contact Bernie Berns of Public Affairs at (314) 444-8321.

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